

## WHITE PAPER

### Submission by Professor Jeffrey Davis, University of Florida College of Law, in Opposition to Sun Trust's Proposed Amendments to Chapters 673 and 674, Florida Statutes.

Sun Trust proposes three amendments. Sun Trust's White Paper speaks to only one of them— the one that is the least offensive of the three. I will discuss this proposal first.

#### I. Adding the "or otherwise" language back into the conversion safe harbor.

The White Paper argues that the holding in *Racso Diagnostics, Inc. V. Community Bank of Homestead*, 735 So. 2d 519 (Fla 3d DCA 1999) should be overruled. Under Article 3 of the Uniform Commercial Code, prior to the revisions adopted in Florida in 1992, former section 673.419, authorizing actions for conversion against persons taking an instrument bearing a forged signature, contained a safe harbor for certain banks. It stated:

a depository or collection bank is not liable in conversion *or otherwise* to the true owner beyond the amount of any proceeds remaining in his hands.

The revised section, F.S. 673.4201(3) contains a similar, more limited safe harbor, which lacks the phrase "or otherwise." Because the current version omits the "or otherwise" language, the *Racso Diagnostics* court held that the legislature intended to permit injured parties to bring common law actions for negligence against banks which fail to exercise ordinary care in paying on forged endorsements. As amended, F.S. 673.4201(3) would read as follows:

(3) A representative, other than a depository bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not a person entitled to enforce the instrument is not liable in conversion *or otherwise* to that person beyond the amount of any proceeds that it has not paid out.

Sun Trust recognizes that the courts of numerous states have split on this issue and characterizes the *Racso Diagnostics* holding as a minority view. Sun Trust argues that these cases ignore the overriding public policy of the UCC to provide certainty and uniformity in handling negotiable instruments. The Bank (over)states colorfully, if these courts are followed, "the lack of certainty their rulings create will eventually stall banking and commerce and throw the banking industry and financial community into a state of turmoil."

I have contacted two of the drafters of the revisions, Professor Fred Miller of the University of Oklahoma, and Professor William Warren of UCLA. I asked if the deletion of the "or otherwise" language was intended to permit common law negligence claims. Both have deposited their personal notes in the archives at the University of Pennsylvania library, so precise recollections are not possible. However, neither believed that this was a specific objective. When asked whether they would recommend supporting or opposing the proposed amendment, Warren was noncommittal. Fred Miller said, "I sure hope you do not encourage the enactment of this non-uniform amendment. If anything, I would add a different {38367527;1}

non-uniform amendment that says something like “this section is intended to displace any cause of action other than conversion from acting inconsistently with the rights of the person or persons entitled to enforce an instrument.” I think this means that the possibility of a negligence action against a converting bank should not be displaced. Brooke Overby, whom Sun Trust cites in its White Paper, argues that in narrow categories, an action in negligence will advance the principles of the code, such as where a drawer is harmed by its negligent drawee bank. A. Brooke Overby, *Check Fraud in the Courts After the Revisions to U.C.C, Articles 3 and 4*, 57 Ala. L.Rev. 351, 398 (2005). But these actions would not supplement an action in conversion, because issuers (drawers) are not permitted to sue in conversion. F.S. 673.4021(1)(a).

In my own view, the bank most likely to negligently cause harm is the depositary bank – such as where an undersupervised bank employee is in cahoots with the forger. Since depositary banks are excluded from the protections of the current safe harbor, expanding the protections of representatives other than depositary banks probably won’t do too much harm. On the other hand, I’m not sure what the intermediary and payor banks are afraid of, since ordinary care does not require banks to examine checks that are processed by automated means. F.S. 673.1021(g).

Finally, one cannot tell from the *Racso Diagnostics* opinion whether Community Bank of Homestead was a depositary bank or one that paid cash over the counter. The court simply says the checks were “paid to a thief by Community Bank over forged endorsements...” 735 So. 2d at 520. I was able to obtain from Jay M. Levy, the Miami lawyer who represented Community Bank on the appeal, copies of the Answer Brief of the Appellee and the Appellee’s Motion for Rehearing and to Correct Opinion. The Motion to Correct Opinion states:

This portion of the opinion necessarily implies that the money was paid directly by Community Bank to the thief, something opposing counsel represented to the court on oral argument. In fact, that did not happen. Rather the check was presented to Appellee for deposit by a customer of the bank to its account ( R. 74). Community Bank ...credited the proceeds to its customer’s account. This is not a situation, as this Court was led to believe at oral argument, that a thief walked into the bank and cashed the check at the window. That simply did not occur.

So, assuming the above facts to be true, **Community Bank was a depositary bank!** This, of course, makes sense, because the thief stole a number of large checks over a period of time. One cannot imagine a bank repeatedly paying large amounts of cash over the counter to a stranger. Of course the checks were deposited to the customer/thief’s account. Accordingly, as a depositary bank, Community Bank would be excluded from the protection of the F.S. 673.4201(3) safe harbor, and the proposed amendment *would not alter the result* in the *Racso Diagnostics* case.

The primary beneficiaries of this non-uniform amendment will be banks that cash sizeable checks over the counter for strangers (there are precious few of these) and check cashing services.

## II. Displacing the common law entirely.

One must understand that the entire Uniform Commercial Code operates against the background of the common law. The premise is that the common law will apply unless the Code displaces it. Therefore, unlike the Civil Code, which {38367527;1}

attempts to state all law, the drafters of the UCC felt no need to restate existing law, such as the requirement of consideration for an enforceable contract, or the fact that where a person has been unjustly enriched an action in restitution would lie for return of the benefit conferred. This premise is stated explicitly in very beginning of the Code. Section 1-103(b) states:

Unless displaced by the particular provisions of the Uniform Commercial Code, the principles of law and equity, including the law merchant and the law relative to the capacity to contract, principal and agent, estoppel, fraud, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.

The two remaining amendments proposed by Sun Trust reverse the premise. They would amend Article 3 and Article 4 in the identical manner, by adding subsection (4) to 673.1021 and subsection (3) to 674.102. The new subsection would state:

Where the provisions of this article address a particular subject or provide a particular remedy, then displacement of the common law occurs so that a party's exclusive remedy is pursuant to this article.

First, one should understand that *nothing* in Sun Trust's White Paper speaks in support of, or even mentions, these recommendations.

Rather than displacement by a "particular provision," the only thing these amendments would require for the displacement of the common law is that the article "address a particular subject." The breadth of this provision is breathtaking. By its terms, Article Four *addresses* Bank Deposits and Collections. Is the entire common law thus displaced in the realm of bank deposits and collections? Does Sun Trust realize that the consequence of these amendments could be as far reaching as giving up its right to restitution if it makes an erroneous credit to a customer's account, or its common law right to a banker's lien on deposit accounts, or its right to terminate its contract with a depositor if entered as a result of fraud? These amendments would regularly place courts in the position of trying to figure out how to apply the provision while avoiding absurd results.

The Business Section should vigorously oppose them.